

October 26, 2009

Mr. Russell Golden  
Technical Director  
Emerging Issues Task Force  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk Connecticut 06856

Via e-mail: [director@fasb.org](mailto:director@fasb.org)

File Reference No. EITF 0902

Greetings Mr. Golden;

I appreciate the opportunity to respond to the invitation to comment regarding the Issue formerly known as Issue 09-2. This response was prepared from my reference point coming from the perspective of a former auditor, preparer and consultant. The intent of the response is to contribute to the standard setting process and not to advocate for any specific constituency.

I specialize in issues related to financial reporting at technology based companies; therefore research and development accounting issues have been very relevant during my career.

Noting the standard setters challenge regarding the continually changing landscape and evolution of business models, I appreciate the significant efforts required to produce financial reporting guidance. It appears as if new issues and variations of issues are created by industry at an ever increasing rate.

Nothing in this response is intended to be offensive or demeaning of the hard work and efforts of those involved in the standards setting process.

Thank you in advance for any consideration given to the views expressed in this response.

Respectfully submitted,

Gabriel Zubizarreta  
Principal  
Silicon Valley Accountants

**With respect to Issue 09-2:**

**1. Do you agree with that the cost of acquired tangible and intangible research and development assets acquired in an asset acquisition should be capitalized, regardless of whether they have a future alternative use? Why or why not?**

No.

In order to support the capitalization of an asset the costs should meet the definition of an asset. Under current and this proposed GAAP, most costs for R&D are not capitalized [730-10-25-1] (as they do not generally meet the definition of an asset), therefore, especially in cases where there is not future alternative use, it does not seem at all appropriate to capitalize costs as an asset. This is even more evident in the case of an intangible asset (with no alternative future use) that would be assigned an indefinite life, and therefore, not amortized even if it is a definite lived asset such as a 4 year term software license. In such a scenario, a Company could acquire a 4 year software license, only applicable to a high risk R&D project (no alternative use) and the asset would be capitalized and assigned an indefinite life. No expense would be recognized while the asset was utilized during the R&D project. During the subsequent project years, there would be no amortization and the Company would be required to perform impairment testing. Only after the completion of the project, would a life be assigned and then any amortization would be charged to R&D [730-10-25-1(c)].

By contrast, if the software was developed internally for internal R&D purposes, the treatment would be to expense the costs in all phases of development as R&D, even costs incurred after technological feasibility was established. This treatment is diametrically opposed to most internal use software development accounting, apparently based on the R&D costs not representing costs which should be capitalized. There appears to be inconsistency in the treatment of these costs not related to their use, life or economic value, but rather due to the manner of how the costs were incurred.

Please address how each of these proposed treatments would be reflective of the economics of the respective transactions, and why this would be a reporting improvement.

There seemed to have been very sound logic underpinning to the concept of alternative future use for the recognition of an R&D asset.

**2. Do you agree that contingent payment arrangements in an asset acquisition should not be recognized at fair value unless those arrangements are derivatives?**

Contingent payment arrangements should be recognized consistently based on the value of the consideration regardless of the method of payment (derivative or other). The basis of recognition (cost, fair value, etc) also should be consistently applied for similar transactions. If the value of the transaction is measured at or near the transaction date, then the cost and the fair value should be approximately the same amount.

The value of an asset acquisition should be measured entirely on the day that the asset is acquired. All consideration (contingent or otherwise) should be valued at that day and a cost recorded based on the best reasonable and reliable evidence. Although, in certain instances the value of the contingency may not be readily determinable, the Board has previously accepted management estimates as a basis for transaction values; therefore this would be an appropriate and consistent application of that precedence. If the value of consideration is contingent, then management should estimate the value of the contingency on the date of acquisition and record the cost of the asset based on the most reasonable and reliable estimate available. Notwithstanding precedence, a threshold of "reasonable estimate" at a minimum should be required.

Contingencies which are resolved later are generally affected by events and circumstances that occur after the date of exchange. Additionally, not recording any value to the contingent portion of the transaction would be similar to deferring revenue in that it does not reflect the economics of the transaction and defers recognition to a later date.

In the event, that the contingency is subsequently resolved at an amount greater than the original estimate, then that additional amount would be recognized as current period expense. This treatment would be similar to the current business combination accounting.

In the event, that the contingency is resolved at an amount less than the original estimate, then that difference between the original and the lesser amount would reduce the value of the asset.

Changes to the carrying value of a derivative instrument related to an asset acquisition subsequent to the acquisition date would not be part of the asset cost until the derivative is ultimately settled, whereby the cumulative difference would be treated consistently with differences of other resolved contingencies as stated above.

**3. This proposed Update does not provide guidance for determining whether a contingent payment relates to future services or consideration for the assets acquired. Paragraph 805-10-55-25 provides guidance for determining whether payments made to the seller in a business combination after the acquisition date relate to acquisition of the business or the performance of future services by the seller? Do you believe that additional guidance is necessary for assisting in making this determination in an asset acquisition? If you believe additional guidance is necessary, please provide any factors that you believe should be considered in making this determination.**

Yes, additional guidance would be helpful. The guidance in 805-10-55-25 is good, however the determination of future services or consideration for the asset acquired will be a significant determination. It is unclear if the guidance prefers that an allocation be made, or if any of the consideration relates to future services than all the consideration would be determined to be for future services. Clarity should be provided on a principled approach. Additionally, it would appear that performance based contingent payments related to an acquired asset may either be services or consideration for the asset. Clarification from additional guidance would be beneficial.

#### **Additional Comments:**

##### **Principles based guidance**

It appears that the Board desires to have more principles based guidance. In furtherance of the principles based approach, the principles based guidance in 730-10-5-2 and 730-10-5-3 should be retained. This guidance could be modified, if necessary to meet the current thinking of the Board, but its removal is not in the direction of providing more principles and less prescriptive guidance. This type and level of principles based explanation is extremely useful in practice when preparers have to deal with complex cases that do not follow clear cut examples.

Conversely, the general tone and tenor of the proposed guidance feels increasingly prescriptive; possibly due to its subjective application of logic and use of a more rules based approach.

##### **Clarity regarding R&D software related costs**

It is not clear how costs related to software implementation for purchased R&D software would be treated?  
It is not clear how costs related to software customizations for purchased R&D software would be treated?  
It is not clear how costs related to software maintenance for purchased R&D software would be treated?

##### **Impairment testing**

In many instances it appears impracticable to perform impairment testing on assets used in R&D. The determination of the input factors for early stage R&D efforts seems very difficult, subjective and frankly undeterminable. For some industries with many complex, concurrent R&D projects and assets, this level of impairment testing may represent a significant burden, have limited value, and lead to less meaningful reporting.

## **Comments on Summary Information**

### **Why is FASB issuing this Update?**

Based on the explanation provided, one wonders if the decision to require the capitalization of IPR&D in a business combination is not the only the genesis of this issue, but also an incomplete partial decision. This problem is compounded as this proposed issue is also partial and does not fully address the problems; which is stated in the documentation of this issue. Additionally, the proposed issue does not appear to fully align with IFRS, nor does it address some of the more practical issues noted above. A reconsideration of whether this partial improvement is sufficient to warrant the proposed changes should be seriously considered.

The measurement of contingent consideration does not appear to be definitively addressed either.

### **Why would this be an improvement?**

The articulated benefit is “partial alignment.”

From a balance sheet perspective, amounts are generally most relevant and useful if they are representative of value on the balance sheet date. Although less useful, certain historical amounts maybe of limited use if they are consistently recorded. Unfortunately, under the current R&D approach, the resulting R&D assets will include both fair value and historical cost amounts, some of which will not be amortized and will exclude the internally generated research & development costs. This hybrid presentation will result in an amount which is neither meaningful nor useful and which will be difficult to understand.

From an income statement approach, the absolute values of amounts are less relevant however, the periodic trend of amounts provides much of the value for understanding the entities activities. Based on the proposed treatment, the resultant accounting for R&D costs will be less consistent between periods due to the aforementioned capitalization of asset acquisitions, non-amortized indefinite lives, and periodic impairments. These inconsistent treatments of costs will make the analysis of actual periodic R&D expenses significantly less meaningful.

Optimally, changes in reporting would improve the usefulness of the balance sheet and income statement. Occasionally, changes are such that the improvement in one statement outweighs a contrary effect on the other statement. It would seem that if neither statement is benefitted, then the motivation for the change should be reexamined.

In summary, the treatment of R&D costs should be consistent regardless of the origin, method of payment, transaction type or type of asset. This treatment should be based on conceptual principles and result in amounts which can be meaningfully understood and reflect the underlying economics of the transaction. If convergence with IFRS is going to be a driving factor, then the conceptual understanding of what these cost represent and which costs are to be capitalized should be addressed initially and all related treatments of costs addressed simultaneously and consistently. A partial solution approach should be considered only as a least preferred approach.